(16)

No. 93-489

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

O'MELVENY & MYERS,
a Law Partnership,
Petitioner,
v.

FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR AMERICAN DIVERSIFIED SAVINGS BANK, ADC FINANCIAL CORPORATION, AMERICAN DIVERSIFIED/WELLS PARK II, and AMERICAN DIVERSIFIED/GATEWAY CENTER,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

I. FIRREA SPECIFIES THAT STATE LAW IS THE SOURCE OF THE FDIC'S RIGHTS.

A. The FDIC's response to petitioner's showing that FIRREA plainly precludes reliance upon a federal rule of decision in this case rests on a single premise: According to the FDIC, under *United States* v. *Texas*, 113 S. Ct. 1631 (1993), federal court power to create federal common law survives federal legislation unless the latter "speaks directly" to the specific legal issue. FDIC Br. 35-36, 38. According to the FDIC, *Texas* is not satisfied because 12 U.S.C. § 1821(d)(2)(A)(i) does not "speak directly" to a defense based on imputation.

As this Court made clear in *Texas*, however, the "speak directly" test applies only when there was an "existing," directly on-point federal common law rule prior to the statute. 113 S. Ct. at 1634. Specifically, in *Board of Comm'rs* v. *United States*, 308 U.S. 343 (1939), the Court had ruled that the federal government's right to prejudgment interest extended in particular cases to contractual "debts owed by state and local governments." *Texas*, 113 S. Ct. at 1634. The Debt Collection Act of 1982 enacted a "more onerous" rule for private debts, requiring mandatory prejudgment interest at a specified rate, but expressly exempted state and local government debts from the stricter statutory rule. *Id*. at 1635. The Court held that the more moderate, *preexisting* rule in *Board of Comm'rs* still applied to States. See *id*. at 1635-36.

Here, by contrast, prior to FIRREA there was no federal rule of decision, much less a directly on-point precedent of this Court, precluding the application of state law to professional malpractice claims brought by the FDIC. To the contrary, the most relevant precedents of this Court hold that tort claims against thrift receivers are governed by "state law." *Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 585 (1989), and that the claims of federal receivers are generally subject to

defenses available against the institution, including defenses based on imputation, see Pet. Br. 20-21; *infra* at p. 12. Consistent with these precedents, prior to FIRREA lower courts had regularly held that state law governed tort claims brought by the FDIC and FSLIC, and the defenses thereto. See Pet. Br. 25 n.19.

Accordingly, the FDIC's reliance on *Texas* is misplaced because it is "difficult to argue," to say the least, that FIRREA "preserve[d] a federal common law remedy not yet recognized by this Court." *City of Milwaukee* v. *Illinois*, 451 U.S. 304, 327 n.19 (1981). The opinion of Justice Douglas for the Court in *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), simply does not address whether, when the FDIC sues for malpractice, federal rules of decision should be created to supply the elements of FDIC's tort claims or the permissible defenses. The FDIC concedes that *D'Oench* is distinguishable and addresses only "the question whether a secret side agreement may constitute a defense to an action on a note by FDIC." FDIC Br. 38; see Pet. Br. 42 n.31, 46 n.33, 47 n.34. Both *D'Oench* and later decisions of this Court emphasize that *D'Oench* is limited to a defense by a borrower who knowingly participated in a secret agreement. See Pet. Br. 46 n.33.[1] Because the holding in *D'Oench* is unrelated to the issue here, the "speak directly" test does not apply.[2]

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[1] The FDIC miscites two preemption cases. In *Deitrick* v. *Greaney*, 309 U.S. 190 (1940), a borrower participated, "with full knowledge of the unlawful purpose," in the violation of a federal statute. *Id.* at 195, 198-201. In *Texas & Pacific Ry.* v. *Pottorff*, 291 U.S. 245 (1934), a depositor knowingly participated in a statutory violation. *Id.* at 252-54. Moreover, *Pottorff* involved a claim that could have been successfully brought by the bank (*id.* at 260), and dicta concerning a receiver's right to recover fraudulent conveyances, *id.* at 261, a right which is now codified at 12 U.S.C. § 1821(d)(17). Later decisions emphasize that *Greaney* and *Pottorff* are preemption cases. *See, e.g., Sola Elec. Co.* v. *Jefferson Co*,. 317 U.S. 173, 176 (1942); *Awotin* v. *Atlas Exchange Bank*, 295 U.S. 209, 213 (1935).

[2] Even if that test did apply, it would be satisfied here. To satisfy the test, Congress "need not 'affirmatively proscribe' the common law doctrine at issue." *Texas*, 113 S. Ct. 1634-35; *accord Astoria Fed. Sav. & Loan Ass'n* v. *Solimino*, 111 S. Ct. 2166, 2170 (1991) (there is no requirement of "clear statement" or "strict construction"); *City of Milwaukee* v. *Illinois*, 451 U.S. at 317 ("evidence of a clear and manifest purpose is not required"). Rather, the "speak directly" test is satisfied by the "natural meaning" of a statutory provision, *Isbrandtsen Co.* v. *Johnson*, 343 U.S. 779, 783 (1952), by a statutory listing of powers that omits the power claimed to exist under the common law, *id.* at 789, by a statutory provision that would be rendered "superfluous" by continued application of a common law rule, *Astoria*, 111 S. Ct. at 2172, or by "an implication" after application of the traditional tools of statutory interpretation, *id.* at 2171. Each of these is present here. *See infra* at pp. 4-7; *see also* Pet. Br. 19-31.

What the FDIC seeks is not to preserve a federal tort rule that existed before FIRREA, but rather to create a new federal common law rule that goes well beyond both *D'Oench* and the statute.[3] In this situation, the Court must first determine whether a statute "addresses" the subject of FDIC's proposed federal common law rule of decision. *E.g., Northwest Airlines, Inc.* v. *Transport Workers Union*, 451 U.S. 77, 95 n.34 (1981).[4] Section 1821(d)(2)(A)(i) of Title 12 plainly does.

[3] Of course, in *Langley*, the FDIC argued strenuously that *D'Oench* was broader than 12 U.S.C. § 1823(e) and that this interpretation of *D'Oench* remained good law after enactment of the statute. *See* Brief For The FDIC, at 36-41 (No. 86-489). The Court squarely rejected this argument: "An agreement that meets [the requirements set forth in § 1823(e)] prevails even if the FDIC did not know of it . . . . It would be rewriting the statute to hold otherwise." *Langley* v. *FDIC*, 484 U.S. 86, 95 (1987).

[4] The FDIC attempts to distinguish *Northwest Airlines* and *City of Milwaukee* on the basis that the statutes there were comprehensive (*see* FDIC Br. 36, 38-40); but FIRREA is unquestionably comprehensive. *See* Pet. Br. 19, 21-28, 44-45; FDIC Br. 29-30, 42-46. Indeed, FIRREA's legislative history states that the statute's delineation of FDIC's rights as a receiver is "comprehensive." H.R. Rep. No. 54(I), 101st Cong., 1st Sess. 415 (1989). More fundamentally, it is contrary to this Court's precedent to suggest that the Court should not follow a statute that addresses a subject because the statute is not sufficiently "comprehensive." *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618, 625 (1978) (rejecting argument that it was proper "to 'supplement' Congress' answer" on the

B. At the heart of the FDIC's proposed federal tort rule is the proposition that the FDIC enjoys greater rights against petitioner than did FDIC's predecessor, ADSB. See FDIC Br. 11, 27, 35. This contention is squarely, indeed directly, refuted by 12 U.S.C. § 1821(d)(2)(A)(i), which provides that in this case the FDIC as a receiver operates as a "Successor to [the] institution" and asserts the "rights . . . of the insured depository institution." See also *infra,* at pp. 12-13. This provision instructs a court to apply the same rule of decision to the FDIC's tort claims as applies to the claims if brought by the savings and loan. The FDIC does not dispute that state law governs tort claims brought by the savings and loan itself and the defenses thereto. See *Bank of Am. Nat'l Trust & Sav. Ass'n* v. *Parnell,* 352 U.S. 29, 33-34 (1956); Pet. Br. 23-26.[5] Because the statute answers the question of which law to apply, there is simply no need for further application of the *Kimbell Foods* test.

The FDIC makes only two arguments to the contrary. The first is the remarkable contention that the delineation by Congress of specific rights and remedies does not "in any way" limit judicial authority to create additional federal common law rights. FDIC Br. 41. This argument renders meaningless the statutory provision that specifies

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basis that "Congress has never enacted a *comprehensive* maritime code") (emphasis added).

[5] The FDIC also does not dispute that state law applies to the claims of the other three plaintiffs in this case—*i.e.,* ADSB's subsidiary, ADCFC, a California corporation, and the two partnerships in which ADCFC is general partner. As *amici* demonstrated, pursuant to *Finley* v. *United States,* 490 U.S. 545 (1989), the federal courts lack jurisdiction over the claims of these three plaintiffs. *See* Brief For The American Bar Association As Amicus Curiae ("ABA Br."), at 12 n.22; Brief Amicus Curiae of Banking and Business Lawyers, at 12 n.16. Pursuant to "the duty of this Court to see to it that the jurisdiction of the [district court] . . . is not exceeded," *City of Kenosha* v. *Bruno,* 412 U.S. 507, 511 (1973) (quotations omitted), the Court should order the claims of the three other plaintiffs dismissed.

rights. It also directly contravenes this Court's decisions holding that federal common law rules may not be created to supplement the rights or remedies Congress had adopted—especially where, as here, Congress itself has modified the statute over time to add appropriate remedies. See Pet. Br. 28-29 (citing five cases).

The other FDIC argument is based on the commonplace provision of the statute that grants the FDIC "such incidental powers as shall be necessary to carry out" the FDIC's express statutory powers. 12 U.S.C. § 1821(d)(2)(J). The FDIC's interpretation must be rejected because it obviously would make the specification of the FDIC's rights in Section 1821(d)(2)(A)(i) a "practical nullity." *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.,* 484 U.S. 365, 375 (1988); *Jarecki* v. *G.D. Searle & Co.,* 367 U.S. 303, 307 (1961) (rejecting statutory interpretation of one provision that would swallow up other, narrower provision: "If there is a big hole in the fence for the big cat, need there be a small hole for the small one?") (internal quotations omitted).

Indeed, this Court has previously rejected the FDIC's proposed interpretation of the ubiquitous statutory provision that grants agencies "incidental" powers. In *Brannan* v. *Stark,* 342 U.S. 451 (1952), a statute specified the provisions that an agency could include in an order and added that the order could include auxiliary provisions "incidental to the enumerated terms and conditions." *Id.* at 463. The Court held that the agency's "incidental" authority could not be strained to include any matter of "basic importance" because Congress would not "hang one of the main gears on the tail pipe." *Id.* FDIC concedes that eliminating state-law requirements for a valid tort claim is a matter of fundamental importance. Moreover, the FDIC's claimed power to avoid requirements of state tort law is inconsistent with the express statutory provision that provides that the FDIC asserts the "rights . . . [and] powers . . . *of the insured depository institution.*" (Emphasis added.) Under *Brannan,* such an "inconsis-

tent" power "cannot be incidental to the enumerated" powers of the agency. 342 U.S. at 463.

In contrast to the irrelevant Section 1821(d)(2)(J), other statutory provisions provide strong support for holding that state law governs the tort issues in this case. See Pet. Br. 21-25. The FDIC does not dispute that in FIRREA Congress expressly departed from state law to create a number of federal rules of liability. The FDIC concedes that although Congress considered a variety of issues concerning appropriate remedies against savings and loan attorneys, see *id.* at 24 n.17, 27-28, none of the FIRREA statutory provisions that federalize an issue applies to the imputation issue in this case. This Court has repeatedly held that when, as here, Congress has legislated in an area and expressly created federal rules for certain issues, the Court will not create federal common law rules for other issues. See *id.* at 22 & n.15 (citing four cases); see also *Andrus* v. *Glover Constr. Co.*, 446 U.S. 608, 616-17 (1980) ("Where Congress explicitly enumerates certain exceptions to a general [rule], additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.").

Similarly, the government ignores (FDIC Br. 46) that this Court has held that "[f]ederal courts lack authority" to create federal common law remedies that are "more stringent" than the administrative remedies enacted by Congress. *City of Milwaukee*, 451 U.S. at 320; see *Northwest Airlines*, 451 U.S. at 97-98. Indeed, even when the defendant's conduct violates a federal statute, the Court has repeatedly held that the presence of administrative remedies makes the Court "especially reluctant" to recognize an implied right of action creating a broader or different remedy. *E.g., Karahalios* v. *National Fed'n of Fed. Employees*, 489 U.S. 527, 533 (1989). *A fortiori*, Congress' enactment here of administrative remedies *limited* to "reckless" attorney conduct is entirely inconsistent with what the government seeks—judicial creation

of federal tort rules for alleged conduct by petitioner that concededly would not violate any federal statute.[6]

II. UNDER *KIMBELL FOODS*, STATE LAW SUPPLIES THE RULE OF DECISION.

A. The FDIC Has Failed To Show A Need For A "Nationally Uniform Body of Law."

1. The FDIC does not dispute that in this case, and routinely in others, the FDIC seeks to mix aspects of state law[7] favorable to the agency with federal rules of deci-

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[6] The FDIC also cites to the FIRREA statutory purpose "[t]o strengthen the enforcement powers of Federal regulators." § 101 (9), 103 Stat. 187 (1989). The FDIC omits that under FIRREA "enforcement powers" expressly refers to the administrative remedy provisions in Title IX, Subsection A, *see id.* at 446 *et seq.*, not to the "Conservatorship and Receivership Powers" of the FDIC under Section 212, *see id.* at 222.

[7] Contrary to the FDIC's suggestion (FDIC Br. 10), the Ninth Circuit did not hold that petitioner was negligent. The Ninth Circuit stated in dictum that lawyers have a general duty to investigate representations by a client's senior officers and owners, and that there was a question of fact whether petitioner had fulfilled this duty. *See* Pet. App. 8a-9a. Even if this Court affirms, the lower courts should be directed to reexamine this dictum because it contradicts a decision of the California Supreme Court issued *after* the Ninth Circuit's ruling. *See Bily* v. *Arthur Young & Co.*, 3 Cal. 4th 370, 397-98, 404-06, 834 P.2d 745, 761, 766-67 (1992) (in deciding professional duty, court must consider increased costs and decreased availability of services, as well as whether claimed benefits of duty have empirical support). *See, e.g., Huddleston* v. *Dwyer*, 322 U.S. 232, 236 (1944) (remanding for consideration of subsequent state court decision that created "doubt"); *Vandenbark* v. *Owens-Illinois Glass Co.*, 311 U.S. 538, 543 (1941) ("until such time as a case is no longer *sub judice*, the duty rests upon federal courts to apply state law under the Rules of Decision statute in accordance with the then controlling decision of the highest state court"); *see also Miree* v. *DeKalb County*, 433 U.S. 25, 33 (1977) (remanding to apply state law and reexamine prior dicta).

The FDIC also misstates certain facts in its effort to show that petitioner was negligent. For example, Rogers & Wells did not undertake an "independent investigation" (FDIC Br. 7), but rather passively received information from Arthur Young and Touche

sion on issues where state law is unfavorable. See Pet. Br. 34-36. Nor does the FDIC dispute that this Court has held three times that such attempted mixing-and-matching is "intensely material" to rejecting a government agency's request for a federal rule of decision on a particular issue. *United States* v. *Yazell,* 382 U.S. 341, 346, 357 (1966); see Pet. Br. 34. The government's citation to *Boyle* v. *United Technologies Corp.*, 487 U.S. 500 (1988), is misplaced. In *Boyle,* the defendant sought a federal rule that would be dispositive of the state-law claims brought by the plaintiff. See *id.* at 514. Nothing in *Boyle* permits what the FDIC seeks here: that the same party be allowed to mix and match elements of state and federal law to create a hybrid claim or defense recognizable under neither. See Pet. Br. 26-28, 34-36.

2. The FDIC's contention that the law in the various states uniformly supports its position is simply not accurate. The Ninth Circuit proposed a rule under which imputation would not be permissible if the agent's conduct had ultimately caused loss to the company. See Pet. App. 12a, 15a. Petitioner has demonstrated that this proposed rule is contrary to the express decisions of the California courts, this Court, and state courts in general. Pet. Br. 37-41. As stated by the leading California Supreme Court case, there are "exceptions" under which the knowledge of an agent acting adversely to the principal is imputed to the principal—including when "the agent is in fact acting for his principal in the transaction, even though he may have an opposing personal interest." *McKenney* v. *Ellsworth*, 165 Cal. 326, 329, 132 P. 75, 76 (1913). That "exception" applies as a matter of law to this case because it is undisputed that Sahni and Day were the sole owners and controlled the management of ADSB, as well as the particular transactions at issue. See Pet. Br. 2-3,

Ross—information that was never supplied to petitioner. *See* E.R. 891-92, 910-28, 954-59, 3316-17. Indeed, *after* Touche Ross informed Rogers & Wells of ADSB's financial problems, Rogers & Wells permitted ADSB to close the Vineyard Way transaction without any change to the PPM. *See* Pet. Br. 6-7.

37-38; accord *Federal Land Value Ins. Co.* v. *Taylor*, 56 F.2d 351, 354 (9th Cir. 1932) (California law).[8]

The FDIC does not attempt to defend the Ninth Circuit's proposed federal tort rule. Rather, the FDIC invents two federal tort rules of its own. As part of its effort to distinguish numerous imputation decisions as applying only to commercial cases, the new rules fashioned by the FDIC are that imputation is impermissible when (1) the defendant is accused of negligence (see FDIC Br. 16, 25) or (2) the plaintiff represents an insolvent company (see *id.* at 18-19, 25-26). These newly proposed federal tort rules, however, suffer from the same defects as the Ninth Circuit's proposed rule: they are

[8] Petitioner does *not* concede that Sahni and Day were acting adversely to ADSB. When an agent's conduct brings money into the company, as here, this provides a short-term benefit and, even when there is longer-term detriment, the agent's conduct is not considered adverse to the company. *See FDIC* v. *Shrader & York,* 991 F.2d 216, 223-24 (5th Cir. 1993) (applying Texas law), *cert. pending,* No. 93-651; *Cenco Inc.* v. *Seidman & Seidman,* 686 F.2d 449, 456 (7th Cir.) (Illinois law), *cert. denied,* 459 U.S. 880 (1982); *Schneider* v. *Thompson,* 58 F.2d 94, 98 (8th Cir. 1932); *FDIC* v. *Deloitte & Touche,* 834 F. Supp. 1129, 1136 n.7, 1138-40 (E.D. Ark. 1992) (Arkansas law); *In re Wedtech Secs. Litig.*, 138 B.R. 5, 6, 9 (S.D.N.Y. 1992) (New York law); *Security Am. Corp.* v. *Schacht,* No. 82-C-2132 (N.D. Ill. 1983) (available on LEXIS) (Illinois law); *Seidman & Seidman* v. *Gee,* 625 So. 2d 1, 3 (Fla. Dist. Ct. App. 1992). Other courts have even more directly rejected the cause of action proposed by the FDIC and held that, without regard to imputation, the short-term benefit of bringing in money means that neither the corporation nor its successor can establish proximate cause, particularly in a negligence case. *See Bergeson* v. *Life Ins. Corp. of Am.*, 265 F.2d 227, 233-34 (10th Cir.) (Utah law), *cert. denied,* 360 U.S. 932 (1959); *Stratton* v. *Miller,* 113 B.R. 205, 210 (D. Md. 1989) (Maryland law), *aff'd,* 900 F.2d 255 (4th Cir. 1990); *see also Bloor* v. *Carro, Spanbock, Londin, Rodman & Fass,* 754 F.2d 57, 62 (2d Cir. 1985) (federal securities fraud law); *Rochelle* v. *Marine Midland Grace Trust Co.,* 535 F.2d 523, 528-29 (9th Cir. 1976) (same); *Johnson* v. *Chilcott,* 590 F. Supp. 204, 208-09 (D. Colo. 1984) (same); *Holland* v. *Arthur Andersen & Co.,* 571 N.E.2d 777, 782-83 (Ill. Ct. App. 1991) (fraud and breach of contract).

contrary to the express decisions of the California courts,[9] this Court, and other courts.

Flagg v. *Seng*, 16 Cal. App. 2d 545, 60 P.2d 1004 (1936), squarely holds that an outside professional can prevail in a *negligence* suit by a trustee for an *insolvent* corporation based on the imputed knowledge of those who control the corporation. *Id.* at 551, 60 P.2d at 1007; see also *Austin* v. *Hallmark Oil Co.*, 21 Cal. 2d 718, 728-29, 134 P.2d 777, 783-84 (Cal. 1943) (fraud of party was waived based on imputed knowledge of other party's corporate officers); *McKenney*, 165 Cal. at 327, 132 P. at 76 (imputation applied to receiver of failed bank). *Flagg* makes plain that when the controlling officers or directors have knowledge of that which the professional allegedly failed to discover and disclose, neither the corporation nor its successor can establish the necessary "causal relation." 16 Cal. App. 2d at 551, 60 P.2d at 1007. Specifically, the proximate cause element of a claim for professional malpractice requires justifiable reliance. *E.g.*, *Atari Corp.* v. *Ernst & Whinney*, 981 F.2d 1025, 1030 (9th Cir. 1992) (California law). In *Flagg*, as here, neither a

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[9] As requested by both parties, it is appropriate for this Court to make its own examination of California law. First, there is no doubt as to the correct result under California law. *E.g.*, *Bernhardt* v. *Polygraphic Co. of Am.*, 350 U.S. 198, 205 (1956); *see* Pet. Br. 37-39; *infra*, at pp. 10-11, 14. Second, this Court has determined state law for itself when a circuit court erroneously chose to apply federal law. *E.g.*, *West* v. *AT&T*, 311 U.S. 223, 238-39 (1940). Third, this Court determines the scope of state law where its scope may be pertinent to part of the Court's inquiry—here, the consistency of California law with the law of other states and prior federal law decisions. *See, e.g.*, *Gooding* v. *Wilson*, 405 U.S. 518, 524 (1972); *De Sylva* v. *Ballentine*, 351 U.S. 570, 580-82 (1956).

Contrary to the FDIC's new position (*see* FDIC Br. 15 n.3), it is clear that the court of appeals applied federal law to the issue of imputing the knowledge of Sahni and Day to ADSB. The Ninth Circuit's decision rested solely on federal cases, contradicted applicable California decisions, and stated that "[i]t is by now clear beyond doubt that federal, not state, law governs the application of defenses against FDIC." Pet. App. 11a-13a; *see* Pet. Br. 37-39; *infra*, at pp. 10-11, 14. The FDIC had previously and correctly informed this Court that the Ninth Circuit relied on *federal* law on this issue. *See* FDIC Br. on Pet. for Cert., at 3 n.2, 4.

corporation, nor its successor, can establish proximate cause because the persons in control of the institution "were . . . not deceived." 16 Cal. App. 2d at 551, 60 P.2d at 1007.[10] Even the FDIC cannot dispute that an allegedly negligent defendant may prevail when the plaintiff is unable to establish proximate cause.

Numerous cases applying the law of other states are in accord with *Flagg* that in a *negligence* case against a professional, imputation may properly be used to show that a receiver or trustee of an *insolvent* corporation cannot establish proximate causation or justifiable reliance. See, *e.g.*, *FDIC* v. *Ernst & Young*, 967 F.2d 166, 169 (5th Cir. 1992) (Texas law); *FDIC* v. *Deloitte & Touche*, 834 F. Supp. at 1138-40 (Arkansas law); *Begier* v. *Price Waterhouse*, 135 B.R. 222, 224 (E.D. Pa. 1991) (Pennsylvania law); *Stratton* v. *Sacks*, 99 B.R. 686, 692, 694 n.9 (D. Md. 1989), *aff'd*, 900 F.2d 255 (4th Cir. 1990) (Maryland law); *Gee*, 625 So. 2d at 3; see also *Bergeson*, 265 F.2d at 232 (Utah law in a derivative suit).[11]

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[10] The FDIC ignores its need to establish justifiable reliance, instead equating its very attenuated theory of but-for causation with proximate causation. *See* FDIC Br. 13-14. This failure to distinguish but-for causation from proximate causation is erroneous under both federal and California law. *See Holmes* v. *SIPC*, 112 S. Ct. 1311, 1317 (1992); *Girard* v. *Monrovia City Sch. Dist.*, 121 Cal. App. 2d 737, 742-43, 264 P.2d 115, 119 (1953). Equally erroneous is the government's remarkable statement that "the *allegations* of causation here must be taken as true on a motion for summary judgment." FDIC Br. 23 n.11 (emphasis added). *See, e.g.*, *Lujan* v. *Defenders of Wildlife*, 112 S. Ct. 2130, 2137 (1992); *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 319, 322-24 (1986).

Even if the issue were denominated estoppel, California law plainly would permit an allegedly negligent party to raise imputation. *See Austin*, *supra*. Other States are in accord. *See Lettieri* v. *American Sav. Bank*, 437 A.2d 822, 827-28 (Conn. 1980); *Crystal Ice Co.* v. *First Colonial Corp.*, 257 S.E.2d 496, 498 (S.C. 1979); *Sussel* v. *First Fed. Sav. & Loan Ass'n*, 238 N.W.2d 625, 628 (Minn. 1976); *see also FDIC* v. *Shrader & York*, 991 F.2d at 226 (Texas law permits imputation absent "collusion").

[11] Cases relied on by the FDIC involve claims of fraud against the defendant for actively causing or concealing the institution's

This Court too has held that a so-called "wrongdoer" (to use the FDIC's label) may prevail against a receiver based on imputation. In *Deitrick* v. *Standard Sur. & Cas. Co.*, 303 U.S. 471 (1938), a pre-*Erie* case, an entity that committed fraud prevailed over the receiver of a failed national bank based on the imputation to the bank of the knowledge of the bank's own fraudulently acting agent. *Id.* at 478-81; see also *Armstrong* v. *Ashley*, 204 U.S. 272, 278, 283 (1907) (receiver). *Standard Surety* thus squarely contradicts both of the FDIC's proposed federal rules of decision. See *supra* at p. 9.[12]

Standard Surety also forecloses the FDIC's argument that a receiver may avoid imputation simply by invoking the interests of creditors. See FDIC Br. 18, 26. *Standard Surety* holds that to make such an argument, at a minimum, the receiver must plead and then prove the elements of specific creditors' claims, including that the defendant acted to "mislead creditors" and the "damages" sustained by the creditors. 303 U.S. at 480.[13]

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insolvency. *See* FDIC Br. 17-18, 27 n.14. There is authority to the contrary when the defendant is an outside professional. *See Cenco*, 686 F.2d at 454; *Feltman* v. *Prudential Bache Secs.*, 122 B.R. 466, 474 n.9 (S.D. Fla. 1990) (Florida law); *Security Am. Corp.* v. *Schacht*, *supra*. In any event, cases where the defendant is sued for fraud are inapposite because the reach of proximate cause is potentially broader for fraud than for negligence. *See, e.g.*, *Tate* v. *Canonica*, 180 Cal. App. 2d 898, 904, 5 Cal. Rptr. 28, 33 (1960); Restatement (Second) of Torts § 435B & cmt. a (1965). Here, the FDIC concedes that it does not even allege fraud by petitioner, nor that petitioner caused or was aware of ADSB's insolvency. *See* FDIC Br. 13, 33.

[12] If federal rules of decision do apply to this case, prior decisions of this Court such as *Deitrick*, *Armstrong*, and others (*see* Pet. Br. 40) would supply those rules. *See Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 367 (1943) (applying pre-*Erie* federal common law). Under those decisions, petitioner prevails.

[13] The FDIC's citation to *McCandless* v. *Furlaud*, 296 U.S. 140 (1935), a pre-*Erie* suit against officers for fraud, is misplaced because *McCandless* "clearly emphasizes that the receiver in that case was suing on behalf of the corporation not third parties; he was simply stating the same claim that the corporation could have

Here, the FDIC has never alleged or proved the elements of a claim by any depositor, as *Standard Surety* requires.[14] This is not surprising; no depositor could satisfy either of the requirements of proximate causation and privity that apply under both California and federal law.[15]

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made had it brought suit prior to entering receivership." *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416, 429 (1972).

[14] Moreover, under the current statute, the FDIC succeeds to the "rights . . . of any . . . depositor . . . *with respect to the institution and the assets of the institution.*" 12 U.S.C. § 1821(d)(2)(A)(i) (emphasis added). The emphasized language means that the FDIC succeeds only to the rights of depositors to bring derivative suits to enforce claims of the institution, not to any direct claims of depositors. *See* Pet. Br. 19-20 n.12.

[15] A creditor cannot establish proximate causation because, as a matter of law, there is no direct relation between the creditor's loss and conduct allegedly causing an injury to the insolvent debtor. *See Holmes* v. *SIPC*, 112 S. Ct. at 1317-20 & n.19; *see also Girard*, 121 Cal. App. 2d at 742, 264 P.2d at 119 ("direct" causation required). In addition, no depositor could establish the basis necessary under California law for a nonclient to sue an attorney: knowledge by the attorney that the depositor would receive and justifiably rely on the attorney's advice. *See Bily*, 3 Cal. 4th at 392, 406-07, 410-11 & n.18, 413, 834 P.2d at 757-58, 767, 769-70 & n.18, 772; *Goodman* v. *Kennedy*, 18 Cal. 3d 335, 344, 556 P.2d 737, 743 (1976). Federal law has an even stricter privity requirement. *See Savings Bank* v. *Ward*, 100 U.S. 195, 200-06 (1880); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214-16 n.33 (1976).

Any privity rule more relaxed than California's would frequently place the attorney in a position of conflict of interest, would threaten the disclosure of privileged attorney-client communications, would "inject undesirable self-protective reservations into the attorney's counselling role," and would result in both "an undue burden on the profession and a diminution in the quality of the legal services received by the client." *Goodman*, 18 Cal. 3d at 344, 556 P.2d at 743 (citation and quotations omitted); *accord Sheldon Appel Co.* v. *Albert & Oliker*, 47 Cal. 3d 863, 882-83, 765 P.2d 498, 509 (1989) (nonclient may not sue attorney for inadequate investigation because this "would tend to create a conflict of interest between the attorney and client, tempting a cautious attorney to create a record of diligence . . . , not for the benefit of the client, but simply to protect himself" from a lawsuit by the nonclient). The FDIC's proposed federal tort rules would effectively

3. Finally, even if there were a split in state law on applicable imputation principles, this would not show an adequate "need for a nationally uniform body of law." *United States* v. *Kimbell Foods*, 440 U.S. 715, 728 (1979). Indeed, in *Yazell*, the Court refused to create a uniform federal rule to replace a Texas rule—coverture—that was "peculiar and obsolete," had been repealed prospectively in Texas, and was followed by only one other state. 382 U.S. at 351 & n.23.

The FDIC's argument for "need" boils down to this: Because federal receivers and bankruptcy trustees do not sue often enough in state court, federal courts will have difficulty ascertaining what applicable state law would be. FDIC Br. 28-31. This argument suffers from at least four fatal defects. First, the FDIC's premise is refuted by this very case. Each of the Ninth Circuit's and the FDIC's three proposed rules of decision is squarely refuted by California cases on point. See, *e.g.*, *Flagg* (loss to company; negligence by defendant; bankruptcy trustee); *McKenney* (loss; receiver); *Austin* (fraud).

Second, the FDIC's premise is refuted by federal court decisions too numerous to recite that have applied state imputation principles in cases brought by receivers or bankruptcy trustees. See *supra* at pp. 9 n.8, 11-12 & n.11, for citations to 10 such cases. Indeed, the *Ninth Circuit* has applied California imputation law to tort claims by bankruptcy trustees. See *In re Wolverton Assocs.*, 909 F.2d 1286, 1297 n.7 (9th Cir. 1990); see also *McKee* v. *American Cas. Co.*, 316 F.2d 428, 430 (5th Cir. 1963); Pet. Br. 21.

Third, federal court jurisdiction over tort suits by the FDIC and bankruptcy trustees is concurrent, not exclusive. See 12 U.S.C. § 1819; 28 U.S.C. § 1334(b). FDIC receivers and bankruptcy trustees can and do sue attorneys and auditors in state courts. See, *e.g.*, *Flagg; FDIC* v. *High Tech Medical Sys.*, 574 So. 2d 1121 (Fla. Dist.

create implied duties from attorneys to the savings and loan's creditors and regulators and thus would have precisely these detrimental effects. *See* Pet. Br. 29, 47-48; ABA Br. 3-4.

Ct. App. 1991); *Holland* v. *Arthur Andersen & Co.*, 571 N.E.2d 777 (Ill. Ct. App. 1991). Insurance liquidators and state-appointed receivers for insolvent corporations also sue in state courts. See, *e.g.*, *McKenney; Gee*, 625 So. 2d 1. Thus, state courts have ample opportunities to address issues of the kind raised in this case.

Fourth, federal courts routinely fulfill their duty "to make [their] own determination of what the [highest state court] would probably rule in a similar case" when, unlike here, there is no applicable ruling from the state courts. *King* v. *Order of United Commercial Travelers*, 333 U.S. 153, 161 (1948).[16] If accepted by this Court, the government's argument that difficulty in ascertaining state law provides a basis for creating a substantive federal rule of decision could easily result in an exception to the principles of *Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938), that swallows the rule. Such an expansion of federal common law would be antithetical to this Court's commitments to both separation of powers and federalism. At bottom, the FDIC's argument is no more than a thinly-disguised restatement of the argument rejected in *Erie* and ever since that the creation of federal court jurisdiction "in and of itself give[s] rise to authority to formulate federal common law." *Texas Indus.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 640-41 (1981).

FDIC's "need" argument does reveal, however, the enormous burden that "creating a judicial substitute" for state law would place on the federal courts, thus providing further support for not doing so. *Wallis* v. *Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966). The FDIC bases its "need" argument on its assertions that the FDIC is an "involuntary" transferee and that its potential liability greatly exceeds the stockholders' equity. FDIC Br. 29-30.[17] These arguments apply equally to bankruptcy trust-

[16] Moreover, 38 states allow certification of state law issues from federal courts to the state's highest court. *See* 17A C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 4248, at 167-68 & nn.30-31 (2d ed. 1988 & Supp. 1993).

[17] The FDIC ignores its own invocation of the interests of creditors, who have engaged in "voluntary" transactions, and the

ees, SIPA trustees, and indeed every trustee, receiver, and liquidator. FDIC Br. 26 (bankruptcy trustees are "comparable"). If the FDIC is entitled to a special immunity from state law, each of these entities will also ask this Court for similar treatment—indeed, that process has begun. See Brief Amici Curiae of SIPC, *et al.*

Even if the federal courts can sort out which plaintiffs get special rules, the lower courts (and, inevitably, this Court) will face the task of deciding issue-by-issue when to create a federal tort rule and what the rule should be. The FDIC's expansive rationale for according it immunity from state law—that its interests are different from state court litigants—by its own logic applies to every issue in a tort suit, as the FDIC's arguments in this Court and the lower courts reveal. See FDIC Br. 41; Pet. Br. 41 & n.29. As it has before, the Court should decline the government's request that the federal courts create an expanding series of federal rules of decision "on a case-by-case basis." *Kimbell Foods*, 440 U.S. at 739 n.42; accord *City of Milwaukee*, 451 U.S. at 325 (refusing to create federal common law on "ad hoc" basis).

B. Application Of State Law Would Not Frustrate Specific Objectives Of The Federal Program.

The FDIC devotes most of its argument that state law would frustrate specific objectives of the federal program to the argument that a federal rule would allow the agency to obtain more money. FDIC Br. 32-33, 44. The FDIC makes no attempt to distinguish the prior cases of this Court rejecting precisely such a "more money" argument. See Pet. Br. 42-43. To the contrary, the FDIC's discussion effectively concedes that the two factors that underlie the rejection of this argument by *Kimbell Foods* are present here. Thus, the FDIC concedes that the statutory scheme provides the government with "substantial power to regulate insured institutions and to determine whether to insure an institution" and thus to protect its financial interests. FDIC Br. 29-30 n.16; see Pet. Br. 44-45. And the FDIC does not dispute that the federal statutory scheme is primarily designed not to maximize federal recoveries, but to encourage lending transactions that might not otherwise occur. See FDIC Br. 11, 30-31; Pet. Br. 45-46. Under these precise circumstances, *Kimbell Foods* holds that it is inappropriate to create a federal rule of decision. See 440 U.S. at 735-37, 739 & n.43.[18]

The sole other objective asserted by the FDIC is the provision by lawyers of "diligent service." FDIC Br. 32. The abrogation of traditional state law imputation principles, however, would more likely lead to fewer services, provided at higher cost, by lawyers willing to take greater risks, as well as other adverse consequences. See Pet. Br. 29-30, 45-46; *supra*, at p. 13 n.15.[19] Moreover, at a minimum, the burden is on the FDIC to show frustration of a *specific* objective found in the "express provisions" of the statute. *Kamen* v. *Kemper Fin. Servs.*, 111 S. Ct. 1711, 1717 (1991); accord, *e.g.*,

unique array of statutory powers that regulators have to limit the FDIC's potential liability, including periodic examinations, limitations on asset growth, increases in capital and insurance premiums, and withdrawal of insurance. *See* Pet. Br. 44-45.

[18] The *government's own estimate* of the amount of the claims affected by the issues herein—a figure that assumes no litigation costs, victory for the government on all other issues, and full collection on all judgments—is *less than one percent* of the total estimated loss from failed savings and loans. *Compare* FDIC Br. on Pet. for Cert., at 5 (No. 93-489), *with* National Commission on Financial Institution Reform, Recovery and Enforcement, *Report to the President and Congress of the United States*, at 4 (July 1993). *See also* Pet. Br. 36-37 n.27.

[19] The FDIC is simply wrong when it asserts that traditional imputation principles somehow leave a lawyer better off when the client's officers commit fraud. *See* FDIC Br. 32-33. If the officers are without fault, the lawyers cannot be sued at all for allegedly failing to uncover officer misconduct. And, if an officer is negligent, the knowledge of the officer is more easily imputed—*e.g.*, without a showing of control or benefit to the company—than if the officer acts fraudulently. *See, e.g., FDIC* v. *Ferguson*, 982 F.2d 404, 406-07 (10th Cir. 1991); *Stratton* v. *Sacks*, 99 B.R. at 694.

Kimbell Foods, 440 U.S. at 728, 735, 738; *cf. Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986) ("Invocation of the 'plain purpose' of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent."). Attorney "diligence" is simply not a "specific" objective of the statute, and the statute provides no guidance on what constitutes such "diligence" or what defenses to recognize when an attorney has allegedly not been diligent. The statute enacted by Congress deliberately goes no further than "reckless" attorney conduct, and even then does not create a federal cause of action or eliminate traditional defenses. See Pet. Br. 27-28, 45. Congress deliberately left professional "malpractice" issues to state law. H.R. Rep. No. 54(I), *supra*, at 415. The policy arguments on whether federal law instead should supersede state law when the FDIC sues an attorney for malpractice, "regardless of the merits of the conflicting arguments, . . . is a matter for Congress, not the courts, to resolve." *Texas Indus.*, 451 U.S. at 646-47.

C. Creation Of A Uniform Federal Rule Of Decision Would Severely Disrupt Commercial Relationships Predicated On State Law.

Although both tort law and the regulation of lawyers are quintessential matters of state law, the FDIC contends that petitioner could not reasonably have expected state law to govern its potential tort liability to its client. The FDIC asserts that no law firm or malpractice insurer could reasonably base its conduct or business on the possibility of a "windfall defense" such as imputation and, moreover, such entities could not be surprised that the later appointment of a federal receiver altered their rights and obligations under state law. FDIC Br. 34.

In deciding whether to offer or insure certain services, however, firms and insurers do consider the full range of issues bearing on a law firm's potential liability, including proximate causation as well as the availability and relative strength of affirmative defenses. The FDIC's contention

to the contrary is counter-intuitive and counter to a number of decisions of this Court. See, *e.g.*, *American Dredging Co.* v. *Miller*, 62 U.S.L.W. 4130, 4134 (U.S. Feb. 23, 1994) (noting that "affirmative defenses such as contributory negligence (which eliminate liability)" are rules "upon which . . . actors rely in making decisions about primary conduct—how to manage their business and what precautions to take"). The FDIC's attempt to dismiss imputation and defenses in general as mere "windfalls" ignores the fact that any determination of liability depends on the interplay of issues such as duty, reliance, proximate causation, and affirmative defenses. Here, for example, the requirement of California law that the FDIC must prove justifiable reliance by ADSB, petitioner's client, sets a reasonable and necessary limit on the potential liability arising from the novel and dubious duty posited by the Ninth Circuit of an attorney to investigate facts furnished by the client. See Pet. Br. 34-35 nn.24-25.

States have a "paramount" interest in balancing the competing policy considerations that underlie issues of duty, reliance, proximate cause, and the other elements that collectively define the extent of tort liability. *Martinez* v. *California*, 444 U.S. 277, 282-83 (1980); *Ferri* v. *Ackerman*, 444 U.S. 193, 198 (1979) ("when state law creates a cause of action, the State is free to define the defenses to that claim, including the defense of immunity" in a legal malpractice action). When federal courts change these rules after the fact, they upset the balance the States have struck and the settled and reasonable expectations of entities that have relied on state law.[20]

The FDIC contends, however, that petitioner could not have expected state law to govern its tort liability to its client because it should have anticipated (1) that ADSB

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[20] *Cf. Pinter* v. *Dahl*, 486 U.S. 622, 654 n.29 (1988) (expanding liability of professionals "risks over-deterring activities related to lawful" transactions); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. at 214-16 n.33 (increasing the " 'hazards' " of professional services raises "serious policy questions" best left to Congress).

might become insolvent, (2) that, in the event of insolvency, a federal receiver would be appointed, *and* (3) that the presence of a receiver would alter petitioner's rights and obligations under state law. FDIC Br. 34. The short answer to this fanciful contention is that, prior to the enactment of FIRREA, a host of federal decisions dating back well before the conduct in this case had held that state law supplied the rule of decision applicable to tort claims asserted by receivers for failed banks and savings and loans. Pet. Br. 25 n.19. Indeed, FIRREA simply confirmed the expectation that state law governs a law firm's rights and obligations vis-a-vis its thrift client both before *and* after appointment of a federal receiver. See *supra*, at pp. 1-2, 4-7.

Accordingly, applying a federal rule of decision to determine a law firm's tort liability to its client indisputably disrupts commercial relationships and expectations predicated on state law. The FDIC has not overcome the "presumption," which the Court has stated is "particularly strong" in this context, that state law applies. *Kamen*, 111 S. Ct. at 1717; see also *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 183 (1989) ("as a rule we should be and are 'reluctant to federalize' matters traditionally covered by state common law").

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted,

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